In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 837.

CRESTA CORPORATION, S.A., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 24a–54a) are reported at 50 T.C. 145. The opinion of the court of appeals (Pet. App. 4a–23a) is reported at 429 F. 2d 1209.

JURISDICTION

The judgment of the court of appeals was entered on July 14, 1970 (Pet. App. 55a). The petition for a writ of certiorari was filed on October 12, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the liquidation and distribution of the assets of a personal holding company to its sole share-

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holder followed by his retransfer of these assets to a second wholly owned personal holding company constituted a corporate reorganization described in Section 368(a)(1)(D) of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Section 368(a)(1) of the Internal Revenue Code and the accompanying Regulations are set forth in the Appendix to the petition (pp. 1a–3a).

STATEMENT

In 1938, Werner Abegg ("Abegg"), a citizen and resident of Switzerland at all times here pertinent, organized the Hevaloid Corporation ("Hevaloid"), a Delaware corporation, to hold and exploit certain patents. In connection with this business, Hevaloid leased certain machinery. Abegg was Hevaloid's sole shareholder. During 1957, the taxable year in suit, Robert A. Cavin ("Cavin"), a close personal friend and investment adviser to Abegg, was the president and sole employee of Hevaloid.

Abegg organized the Cresta Corporation, S.A. ("Cresta"), a Panamanian corporation, in 1941, and owned all of its capital stock. Cresta was inactive from the time of its formation until 1957. (Pet. App. 26a–27a.)

Hevaloid's patents expired in 1955 and, in the same year, it sold the related machinery. Thereafter, during the remainder of its corporate existence, it was a personal holding company engaged solely in the acquisition, holding and disposition of investment assets

(stock and securities, receivables and certain rights in a motion picture). (Pet. App. 28a, 35a.)

On March 28, 1957, Hevaloid's board of directors adopted a plan of complete liquidation and dissolution. In pursuance of this plan, some of its assets were sold, resulting in a gain of $932,701.27. Hevaloid claimed entitlement to nonrecognition of this gain under Section 337 of the Internal Revenue Code, which provides for nonrecognition treatment on the sale or exchange of corporate property made within 12 months after adoption of a plan of complete liquidation. By the end of 1957, Hevaloid had completely liquidated by distributing the cash and unsold assets to Abegg. (Pet. App. 28a–30a.)

Almost immediately after receiving these assets, Abegg transferred them to Cresta, his previously inactive corporation. Cavin was hired by Cresta to serve in the same capacity he had previously served Hevaloid. (Pet. App. 27a.) No determination or ruling under Section 367 of the Internal Revenue Code was ever requested as to any of the above-described transactions. (Pet. App. 35a.) That section provides that gain realized upon the transfer of assets to a foreign corporation is to be recognized unless, prior to the transfer, the Commissioner of Internal Revenue determines that the transfer is not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes.

Viewing these transactions as a whole and applying the liquidation-reincorporation doctrine in order to

tax their substance rather than their form, the Tax Court held that there had been a "reorganization" as defined in Section 368(a)(1)(D), whereby the assets of Hevaloid were transferred to Cresta through Abegg, acting as a mere conduit. Having determined that Hevaloid's business continued in modified form through a reorganization, the Tax Court held that Hevaloid did not qualify for nonrecognition treatment under Section 337 on sales of its assets prior to the transfers, and that, since Hevaloid as the real transferor of assets to Cresta had obtained no Section 367 determination, gain must be recognized on the transfers. The Tax Court further held that Cresta, as the transferee of Hevaloid, was liable for the taxes thus due from Hevaloid. On appeal, the Second Circuit affirmed.

ARGUMENT

The decision below is correct. There is no conflict or other reason for further review.

Petitioner objects to the holding that the transactions constituted a reorganization for federal tax purposes. It does not contest that substance over form (the liquidation-reincorporation doctrine) controls whether the statutory requirements of a Section 368(a)(1)(D) reorganization (hereinafter "D" reorganization) are met. But it urges that two requirements of a reorganization—business purpose and continuity of business enterprise—are absent.

1. Petitioner asserts that the requirement of *Gregory* v. *Helvering*, 293 U.S. 465, that a corporation emerging from a reorganization have a business pur-

pose, is satisfied only if the corporation conducts an active business, as opposed to a passive one such as the holding of investment assets. Accordingly, it argues that a personal holding company does not satisfy the "business purpose" requirement. This argument is incorrect.

In *Gregory* v. *Helvering, supra,* certain corporate assets were transferred in a transaction which would now resemble a divisive "D" reorganization. The corporation emerging from the transaction was a personal holding company, and immediately thereafter was liquidated. Although the transaction was molded so as to conform to the technical "reorganization" requirements, it was undertaken solely to transform ordinary dividend income into capital gain through the ephemeral existence of the emerging corporation. This Court held that since the latter served no business purpose other than tax avoidance, it should be ignored for tax purposes. See *Moline Properties, Inc.* v. *Commissioner,* 319 U.S. 436, 438; *Commissioner* v. *National Carbide Corp.,* 167 F. 2d 304, 306 (C.A. 2), affirmed, 336 U.S. 422; *National Investors Corp.* v. *Hoey,* 144 F. 2d 466 (C.A. 2).

The rationale of *Gregory* does not apply where the emerging corporation, be it a holding company or otherwise, continues in existence after the reorganization and engages in business. See *Chisholm* v. *Commissioner,* 79 F. 2d 14, 15 (C.A. 2), certiorari denied, 296 U.S. 641; *Lea* v. *Commissioner,* 96 F. 2d 55 (C.A. 2). Indeed, if the emerging corporation carries on any legitimate function, its existence is to be recognized for tax purposes. See *Commissioner* v. *National Carbide Corp., supra,* p. 306; *Electrical Securities Corp.* v.

Commissioner, 92 F. 2d 593, 595 (C.A. 2); *National Investors Corp.* v. *Hoey, supra*, pp. 467–468; *Moline Properties, Inc., supra; Paymer* v. *Commissioner*, 150 F. 2d 334 (C.A. 2). There is thus no conflict with *Gregory*. Where, as here, a holding company, continues to engage in the disposition, acquisition, and holding of investments, the authorities uniformly hold that the "business purpose" requirement is met. See, *e.g.*, *Lea* v. *Commissioner, supra.*

2. Petitioner also urges (Pet. 9–11) that there was no reorganization because there was no continuity of business enterprise common to Hevaloid and Cresta. See Treasury Regulations on Income Tax (1954 Code), Sec. 1.368–1(b). In so arguing petitioner mistakenly assumes that the "continuity of business enterprise" test is not met if the surviving corporation does not conduct the same business as the old corporation. This is not correct. The "continuity of the business enterprise" requirement is satisfied if a bona fide corporate entity—as opposed to a mere shell corporation devoid of business purpose—emerges from the reorganization in the conduct of *any* business enterprise. *Becher* v. *Commissioner*, 221 F. 2d 252 (C.A. 2); *Bentsen* v. *Phinney*, 199 F. Supp. 363 (S.D. Tex.); *Pebble Springs Distilling Co.* v. *Commissioner*, 23 T.C. 196, affirmed, 231 F. 2d 288 (C.A. 7), certiorari denied, 352 U.S. 836. In Rev. Rul. 63–29, 1963–1 Cum. Bull. 77, for instance, the Commissioner conceded that a toy manufacturing corporation which emerged from a "C" reorganization as a corporation engaged in the steel distributing business fulfilled the "continuity of the business enterprise" requirement and

thus was entitled to the nonrecognition benefits of the reorganization provisions.

Moreover, in this instance the Tax Court found that Hevaloid had abandoned its patent operations, that it had been operated solely as a personal holding company for a period of over 15 months immediately preceding the reorganization, and that it so characterized itself on its income tax returns (Pet. App. 28a, 35a, 39a). Accordingly, petitioner, which concededly was operated as a personal holding company, succeeded to the exact business in which Hevaloid had been engaged.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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